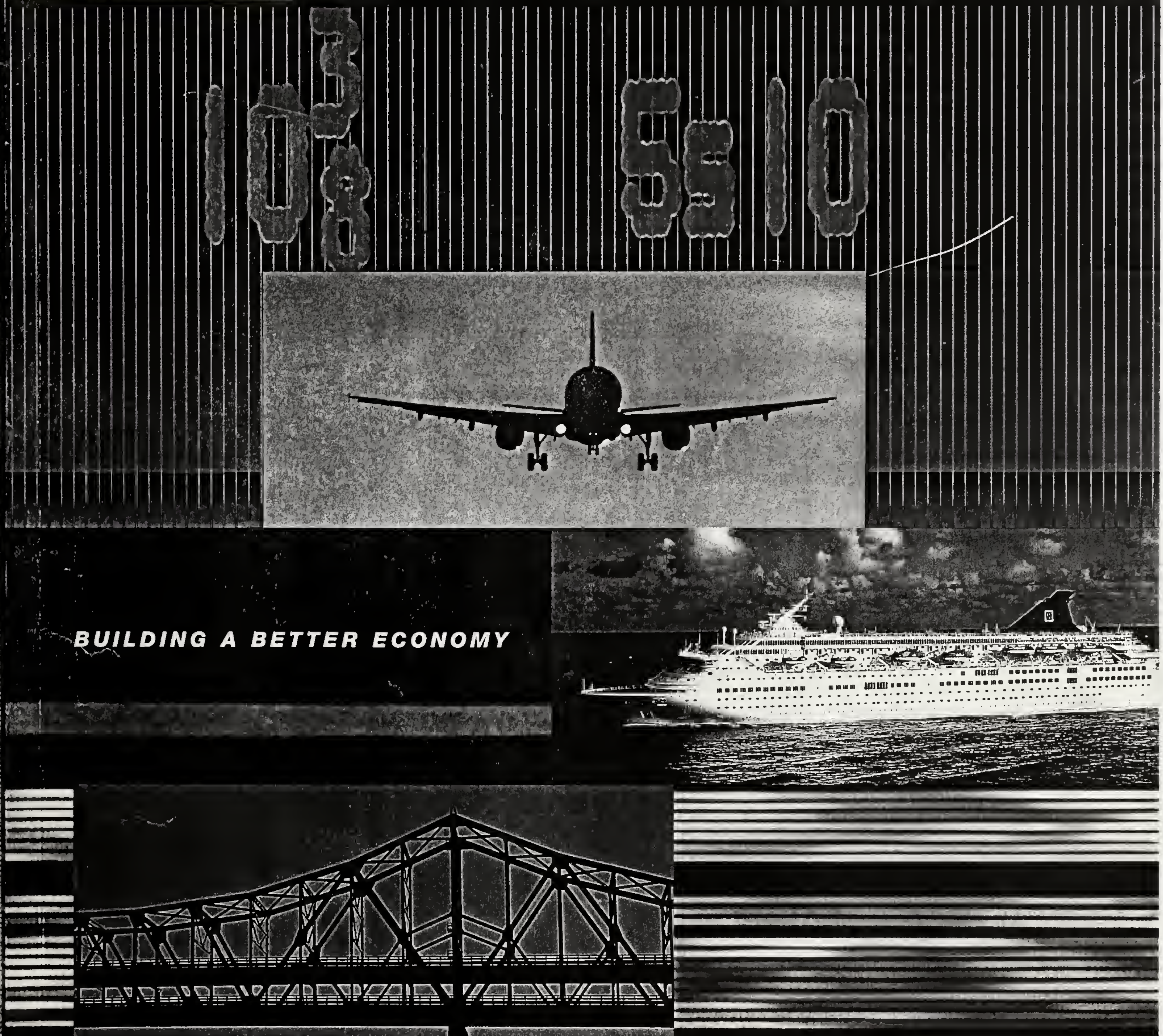
MASSPORT



BUILDING A BETTER ECONOMY

1998 ANNUAL REPORT

Message from the Chairman and Executive Director

Peter Blute
Executive Director & CEO

Mark Robinson
Chairman

In the worldwide marketplace, a region's ability to compete is directly linked to the ability of its transportation system to move people and goods swiftly and cost-effectively. Massport is making sure New England is up to that challenge.

Critical to the future of New England is the $1 billion investment Massport is making to improve Logan International Airport, which celebrates its 75th Anniversary this year. Built in 1923 at the urging of a business community which understood the commercial potential of aviation, Logan has been integral to the economic success of this region for over three quarters of a century.

Logan today directly contributes over $5 billion to the region's economy and is vital to thousands of New England businesses whose bottom line depends on efficient and reliable air service. Driven by a robust economy and a visitor market that ranks 8th most popular in the nation, Logan handles nearly a billion pounds of cargo and 26 million passengers each year. And in the coming years, the new hotels, office towers and convention facilities underway throughout New England will depend heavily on Logan for their future financial success.

Another critical factor for the region is the Port of Boston, which has served as New England's lifeline to the world for over 350 years. Massport has taken bold steps to ensure the seaport continues to give New England a prominent role on the global stage. More than 9,000 jobs are tied to the port, which each year handles 16 million tons of cargo, 1,800 vessels, 70,000 cars, 100,000 cruise passengers and directly contributes $3 billion a year to the region's economy.

Massport has made significant structural improvements to marine terminals and has used creative strategies to make them more productive. Massport has dredged terminal berths and launched harborwide dredging to open the port to deep-draft vessels. New warehouse and distribution space will add 900 additional jobs when finished. These are all important improvements for a port that will be called upon to handle double and triple the volume of cargo in the next 20 years.

As important as these responsibilities are, Massport hasn't forgotten its primary mission to build better communities. And that begins closest to home – in East Boston, South Boston, Revere, Chelsea, Charlestown, Winthrop and all the communities that Massport's many facilities touch. Massport helps build communities in big ways and small. We do it by helping students get their first jobs, by building safe and peaceful parks for residents, by installing soundproof windows to muffle airport noise, and by forming business partnerships that support local economies.

Logan International Airport. The Port of Boston. L.G. Hanscom Field. The Tobin Memorial Bridge. Together, Massport's crucial facilities form a vital transportation network to build a better economy for New England in the decades to come.

Logan International Airport

"Boston's financial services, health care, high technology, higher education and visitor industries all draw their lifeblood from Logan. Combined, these five industries provide more than half of the jobs in our region."

PAUL GUZZI

PRESIDENT,

GREATER BOSTON CHAMBER OF COMMERCE

Logan International Airport has persevered and prospered through three quarters of a century of unprecedented change. But as Logan celebrates its 75th anniversary, one thing has never changed: the vital link that exists between New England's economy, an efficient airport and dependable air service.

Numbers only tell part of the story. More than 900 million pounds of cargo and 26 million passengers move through Logan each year. Logan is like a small city. More than 100 companies and 16,000 workers at the airport contribute $5 billion to the state's economy.

But Logan's reach is wider. Logan is the economic engine that powers Massachusetts and New England. A Boston Globe/MIT study went further: a modern Logan Airport able to handle more than double the present traffic is the linchpin of Boston's development boom. The airport serves a growing market, and as the region's economy demands more from Logan, Massport must continue its forward progress to make sure Logan is up to the challenge.

Logan Modernization

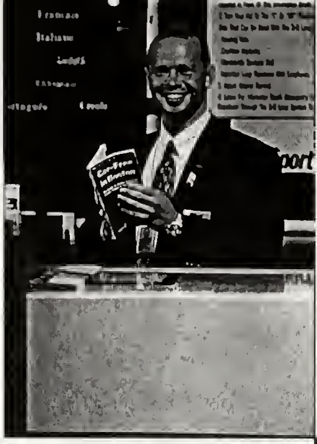
Massport's plan for meeting this challenge is the Logan Modernization project, a comprehensive $1.6 billion public and private investment to position Logan as a world-class facility for the 21st Century.
While some project components are just getting underway, Logan has already reached a number of important milestones.

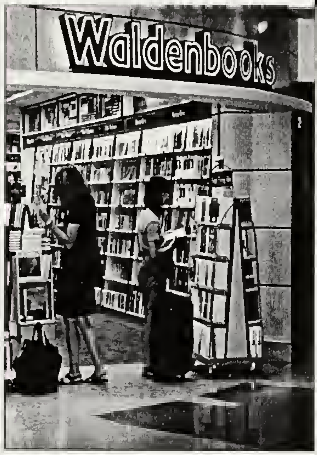
The opening of the new 3,150 space Central Garage addition greatly improves parking at Logan. Completion of covered walkways to Terminals A and E makes it easier for passengers to move swiftly from their cars to their gates via new moving walkways. And walkways to Terminals B and C are scheduled to begin in early 1999. New cargo facilities opened last summer give shippers more direct access to major highways. The growing number of international passengers who use Terminal E are better served now that the first phase of the "International Gateway" expansion and improvement project is complete. As demand for international travel continues to grow, up to 2,000 passengers an hour will be able to easily move through the terminal once the International Gateway is complete.

To eliminate traffic hassles at the airport, construction of a new two-tiered roadway began this fall, while new taxi and limo pools that were opened last year help ease curbside congestion by giving drivers a place to wait until their passengers actually arrive.

To further reduce traffic at the airport, a new $91 million aircraft fueling system now under construction will meet future fueling needs while also cutting the number of tanker trucks traveling airport roads.

Convincing evidence of Logan's strength are the extensive private investments that are being made to improve the airport. US Airways has already completed Phase One of its $35 million upgrade in Terminal B, and United Airlines is meeting expected growth in Boston with a $45 million expansion project of its own in Terminal C. Outside the terminals, visitors to Logan can see the largely-completed 600-room, $100 million Hilton Hotel that is scheduled to open in 1999. By any measure, Logan Modernization is in full swing.





Customer Service

In the long-run, the improvements Massport is making to Logan will mean faster, more convenient, more on-time air travel for the people who use the airport. But short-run disruptions during construction will occur.

That's why Massport is engaged in a full-court press to make sure everything possible is done to ease the burden for Logan's customers. A new valet parking service is being tested this year to cut parking hassles at the airport. In Terminal C, the Boston Landing shopping mall opened its doors with 22 shops offering buyers a wide variety of local and national name-brand products.

Planning is also underway on a comprehensive array of customer-service initiatives to ensure visitors to Logan have a smooth and enjoyable stay. New signs and terminal lighting enhancements will soon be installed at Logan to better guide travelers around the airport and to their destination.

Public Transportation

One out of three passengers traveling to and from Logan got there by public transportation – near the top for major airports in the nation. For the first time in its history, Massport's Logan Express buses served more than a million riders, while nearly 250,000 passengers rode to or from Logan by boat. While these numbers continue a positive three-year trend, Massport is working hard to reach its goal of having 35 percent of its customers commute to Logan in something other than a car.

Airside Improvements

With an average of 100,000 hours of delay each year, Logan ranks as the 6th most delay-prone airport in the country. To address this, Massport is considering a number of physical and operational improvements to the airfield.

Currently under review is a new 5,000-foot, uni-directional runway that would redirect a considerable portion of Logan's current air traffic to over-water-only landings and takeoffs. The new runway could cut delays by 23 percent, under normal conditions, and by as much as 55 percent when Northwest winds limit the airport to a single runway. Restricted to operations over Boston Harbor, the new runway would provide the added benefit of allowing air traffic controllers to divert more flights away from surrounding communities.

To further improve conditions at both Logan and in surrounding communities, Massport is considering a new centerfield taxiway. Like the other airfield improvements under consideration, the new taxiway would ease congestion and delays, reduce noise, improve air quality, cut aircraft taxi time and get passengers to the terminals more quickly.

Hanscom Field / Regional Aviation

At Massport's L.G. Hanscom Field, New England's busiest general aviation airport, flight operations increased nearly five percent last year, reflecting the state's continued strong economy. Hanscom pumped more than $28 million in direct benefits into the local economy, and its 270 workers earned over $14 million. Protecting this important job-creating role, Massport invested over $1 million in airfield, terminal and other facility improvements to maintain Hanscom as New England's premier general aviation airport.

Located just 20 miles from Boston, Hanscom is home to almost 500 permanently based aircraft. The airport serves the diverse flying needs of major corporations, research and development firms, educational institutions, and individual flyers. Hanscom's popularity derives from its excellent location and facilities. Business users cite the airfield's proximity to downtown Boston, and to the Route 128/95 high technology belt. Pilots appreciate the excellent services offered by businesses at Hanscom, including extensive aircraft service and maintenance operations. All told, Hanscom generates an estimated $60 million for New England's economy.

With Boston's growing popularity as a business and tourist destination, Logan's success is increasingly connected to the success of New England's other airports. Since nearly half the flights at Logan are connections to somewhere else in New England, improved service at regional airports is central to better distribution of air traffic in New England.

Though passenger numbers continue to grow at Logan, regional airports have also been able to expand by securing the regular, low-fare service to key U.S. destinations that airlines can now offer with smaller, regional jets.

GROWTH IN PASSENGERS AND CARGO

	1994	1995	1996	1997	1998
Total Passengers	24,225,590	24,232,031	24,778,501	24,918,392	26,020,758
Total Cargo and Mail (000 lbs.)	825,183	931,936	883,001	923,941	996,371

Port of Boston

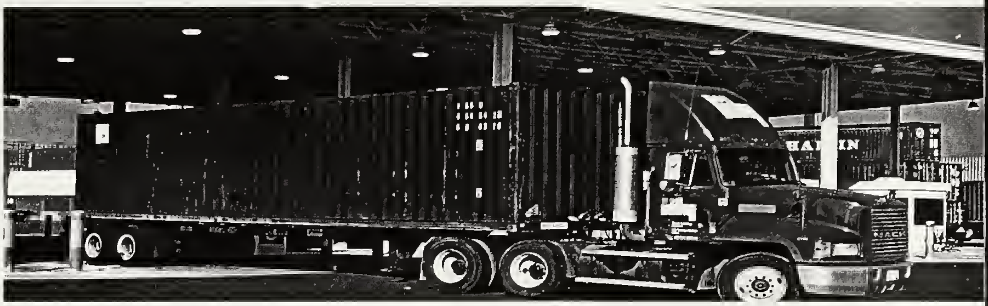
"Boston is the heart of the New England economy. Time is money, and New England's businesses must be able to deliver our products to our customers quickly and cost-effectively if New England is to survive and thrive in today's global economy. To do that, it is essential we have a strong and efficient seaport."

SUSAN B. BELL

INTERNATIONAL TRAFFIC MANAGER

COLE HAAN,

YARMOUTH, MAINE



For more than 300 years the Port of Boston has been a major catalyst for business growth in New England. Today, more than 9,000 jobs are tied to the port. The economic benefits from Massport's facilities alone total $3 billion a year. Last year, the Port of Boston handled 16 million tons of cargo, 1,700 vessels, 78,000 cars, and more than 100,000 cruise passengers.

But the benefits of the port go far beyond these waterfront industries. Every manufacturing and service company in New England reaps economic gain from the working port. Today's economy is global. Foreign trade accounts for one-third of the U.S. GNP. It is responsible for as much as 70 percent of total U.S. economic growth. More than 325,000 jobs in Massachusetts alone are directly tied to exports.

The sheer magnitude of foreign trade today creates enormous opportunities for ports able to seize them, and competition for international business is fierce. Mammoth cargo ships packing more than 4,000 truck-size containers each are standard.

The seaports that survive will be those able to handle this armada of trade easily, speedily, and cost-effectively. To protect New England, Massport is employing a comprehensive agenda to ensure the Port of Boston not only survives, but thrives, in the 21st Century.

Key to this plan is Port Optimization, a creative strategy Massport deployed last spring to improve the efficiency of its terminals. All container trade is now consolidated at the Conley Terminal in South Boston where Massport invested $50 million in four post-Panamax container cranes, deeper berths, and a modern, time-saving 10-lane gate facility. With container operations combined at Conley, Massport turned the Moran Terminal in Charlestown into a state-of-the-art international Autoport. The improved facility can now off-load 400 cars an hour and process over 100,000 cars a year.

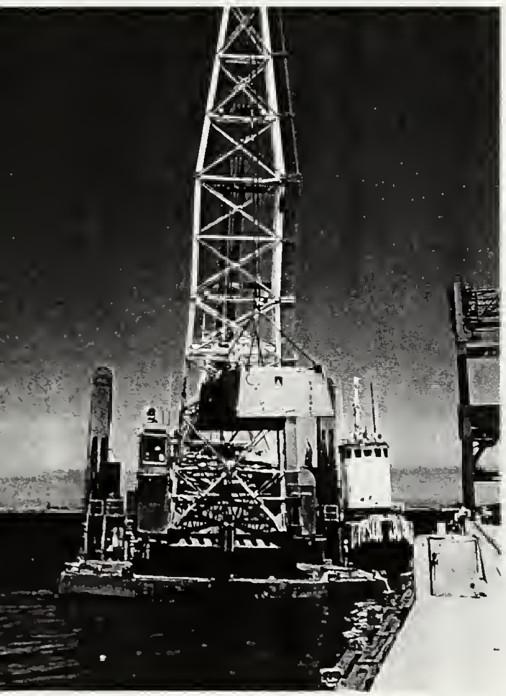
To improve operations for all shippers, Massport is replacing two unused buildings with a 200,000 square-foot warehouse and cargo transfer facility in South Boston. The privately-financed, $35 million project by International Cargo Port Inc., could add 900 more jobs to the port and will give shippers valuable storage space for local and long-haul distribution.

With port optimization, harbor dredging, terminal improvements and new warehouse facilities, Massport is lowering the cost of doing business in Boston. It's an ambitious agenda, but one New England can't afford to do without.

Dredging

To compete in the big leagues, Massport must think big. And with specialized port services, modern terminals, efficient connections between ship, truck and rail, it is. But to compete successfully, what the port needs most is deeper water. To fill that need, Massport and the Army Corps of Engineers last summer launched the final phase of their long-awaited Boston Harbor dredging project.

Phase one of the project was completed last summer when Massport spent nearly $3 million to deepen two berths at the Conley Terminal in South Boston. That improvement gave larger container vessels the clearance needed to remain at the terminal even during low tide. A significant cost-saver for shippers, the timely completion of the Conley dredging project was also key in Massport's ability to consolidate all container operations in South Boston.



Once dredged, Boston Harbor will welcome the newest generation of deep-draft cargo ships, thus lowering the cost of doing business in New England. Backed by more than $60 million in state and federal funding, the harbor dredging project is expected to contribute $5.5 million to the New England economy each year. This massive undertaking will move more than 900,000 cubic yards of silt into 50 separate under seabed cells, each the size of a football field. When complete, the dredging project will improve navigation and safety, reduce cargo handling costs and further control product costs or New England businesses and consumers.

Cruise Port Boston

The cruise industry is a Port of Boston success story. Business in Boston has been brisk, and last season was the best yet at Massport's Black Falcon Cruise Terminal. More than 100,000 passengers on 62 ship calls contributed $30 million to the local economy — the most ever.

With 27 weekly cruises between Boston and the Bahamas, Massport expects to do just as well this year. It is already looking for new ways to improve the Black Falcon Terminal to grab New England's share of the new northern and trans-Atlantic routes the cruise lines are planning.

Business Development

As the largest single landowner in South Boston, Massport is helping to create a new Boston Seaport District. And balancing these commercial opportunities with its responsibilities to the working port is the job of Massport's Business Development department.

The success of Massport's diverse development agenda lies in the balanced portfolio it has already assembled in South Boston. Major projects include: the new Seaport Hotel, a planned hotel, office and residential complex on Parcel F, the new seafood processing plant at the North Jetty; and the new $30 million intermodal cargo facility.

Massport continues to work closely with the community as it maps out its development strategy. Massport is nearing completion on a Memorandum of Understanding with the City of Boston that would mesh Massport's own strategic plan with Boston's Seaport District master plan to help guide development of the area. In East Boston, Massport is closely collaborating with community leaders on a strategic plan for future waterfront development. Key in both areas is Massport's determination to find projects that maximize the potential of its holdings in ways that are consistent with its commitments to the community and its own primary mission.

PORT ACTIVITY

	1994	1995	1996	1997	1998
Containers	86,114	90,921	73,083	72,291	78,737
Cruise Passengers	22,930	90,921	69,075	69,905	109,708
Automobiles	32,304	21,971	36,010	62,282	72,333
Bulk Tonnage	184,963	243,147	355,042	205,621	248,204

Tobin Memorial Bridge

"The Tobin Bridge makes every business in Chelsea a neighbor to every business in Boston. In fact, the Tobin is so identified with the City of Chelsea that the Chamber of Commerce has incorporated the Bridge in its new logo."

DOUGLAS B. MAUCH

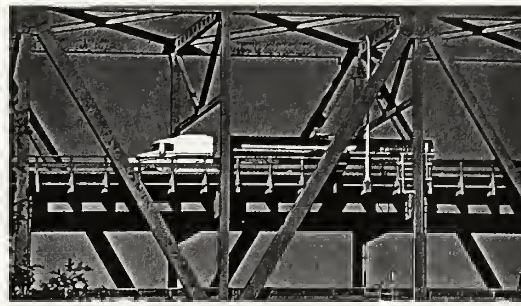
PRESIDENT,

CHELSEA CHAMBER OF COMMERCE

With all of New England on the move, even a half-century old bridge cannot afford to stand still. Keeping traffic moving smoothly and safely across the Tobin Memorial Bridge is a vital part of Massport's strategy for promoting job growth throughout the region.

Massport is investing nearly $1.5 million to install an electronic toll collection system that will retrofit the Tobin for the traffic demands of tomorrow. The 33,000 drivers who cross the bridge each day will see immediate benefits as they move smoothly through toll plazas without fumbling for change or opening car windows to wind, rain and snow.

By eliminating this persistent cause of traffic congestion, residents living near the bridge will also reap the added benefit of less noise and pollution.



And that's not all. By installing electronic tolling on the Tobin, Massport enables the bridge to join a region-wide, integrated, intelligent transportation network.

Through this network transportation planners across the region will be able to better manage traffic, while giving motorists real-time updates on road conditions, tips on alternative routes to avoid traffic jams if they develop, and prompt emergency assistance should a motorist break down.

It's all part of Massport's strategic plan to use state-of-the-art technology to transform the 48 year-old bridge into the new-look Tobin of the future.

International Marketing

"We elected to work again with Massport because it's dedication, commitment and innovative commercial expertise was truly exemplary. Massport understood our products, our markets and our goals."

JAQUELINE M. PAGE

INTERNATIONAL SALES MANAGER

FISKE ASSOCIATES

Helping New England companies expand overseas is a key component of Massport's effort to build a better regional economy. Companies that go global grow faster, last longer, and turn a bigger profit than those that stay home. Exporting extends the life of a company's products, it diversifies the sales base, and provides a hedge against economic downturns.

With trade, tourism, and air route development united under a single roof, Massport's International Marketing Department is positioned to assist companies taking the first big step into overseas trade, or help established global players expand into new markets.

Massport has trade representatives in nine key foreign cities who give businesses the on-the-ground intelligence they need to target buyers in overseas markets, both old and new. And Massport has a full menu of marketing strategies to boost New England's bottom line.

At overseas trade shows, Massport helps line up buyers and handle logistics so companies can spend their time selling products. Massport's Business Development Missions unite small groups of businesses in a wide array of targeted industries to meet with potential overseas buyers one-on-one. Businesses can even tap an overseas market without ever leaving home. If travel's a problem, Massport brings global buyers right to a company's door through its "Incoming Missions" program.

Airline Route Development

International travel is the fastest growing market at Logan Airport, and Massport's Airline Route Development Department is working to keep it that way. Massport scored a big win this year when Air France resumed flights to Logan. This success builds upon recent momentum when Massport added TAP Air Portugal, Korean Air, and Icelandair to Logan's international inventory and increased the number of flights by Lufthansa, Aer Lingus, and American Airline's London service.

Destination Marketing

Logan International Airport and the Port of Boston are the major gateways for tourist dollars that keep New England humming. Tourism is big business in New England, and Boston ranks as the 8th most popular visitor destination in the country.

A critical part of Massport's efforts to lure international visitors to New England are the "familiarization trips" that give travel writers and tour operators a firsthand taste of New England. Massport's network of in-country representatives regularly attend trade and tourism shows around the world to promote New England as a top tourist stop any season of the year.

Community Involvement

"Logan Airport is as much at the center of local and regional economic development as were the shipyards of Donald McKay in the late 1800s."

DAVID MIGLIACCIO

PRESIDENT,

EAST BOSTON CHAMBER OF COMMERCE

The continued strength of New England's economy in the 21st century is the reason Massport is investing so heavily to improve its facilities. But the burden of those improvements is borne most directly by those living and working near these vital transportation facilities. As it pursues business opportunities around the globe, Massport also works hard in its own backyard to ensure Massport's neighbors benefit directly from the economic growth its facilities generate.

In Chelsea, Massport forged a far-ranging economic development compact this year that guarantees $2.5 million over five years for the city. The agreement also creates joint economic ventures that combine Chelsea's economic goals with Logan's need for additional parking, maintenance and freight forwarding space as the airport gets ready for the crush of as many as 10 to 15 million new passengers a year by 2010.

In East Boston, Massport is collaborating with the community on a waterfront development agenda that keeps maritime uses alive, and opens the waterfront to the public while providing economically feasible development opportunities needed to drive new building.

For many local businesses, Massport can be their best customer. Massport's on-going "Logan and Beyond" contract forums give local businesses the information they need to begin a profitable relationship supplying Massport's many needs.

With *South Boston A to Z*, and *The Local Advantage* Massport helps open doors for East Boston and South Boston vendors who want to do business with companies located at Logan Airport and the Port of Boston. The second edition of Massport's popular *Taste of Eastie* East Boston restaurant guide doubled the number of listings. And with its support for the new "Eastie Express" shuttle service, Massport is making it even easier for Logan's 17,000 workers to patronize East Boston businesses.

While it continues to support local businesses, Massport hasn't forgotten the important investment in young people. Each summer, Massport sponsors Student Internship and Community Summer Jobs programs that help get young people off to a good start. Students are put to work in every department at Massport and throughout their local communities as maintenance workers, camp counselors, peer leaders, and lifeguards. Massport-sponsored students work with at-risk youngsters, in day care centers, senior centers and in Head Start programs. Through these programs, young people get the chance to build a brighter future for themselves and their community.

Massport Board Members

The Massport Board consists of seven members appointed by the Governor of Massachusetts to staggered terms of seven years each. Members serve without compensation.

Mark E. Robinson, Chairman, is an attorney at the Boston law firm of Bingham, Dana and Gould.

Term expires 2002.

James M. Coull, Vice-Chair, is chair of the board of J.M. Coull, Inc./JMC Environmental Systems of Concord, a full-service construction firm.

Term expires 2001.

John A. Curry is president emeritus of Northeastern University in Boston.

Term expires June 1998.

James H. Carangelo is president of Business Planning Associates of Lynnfield, an employee benefit and estate planning firm.

Term expires 1999.

George W. Cashman is president and chief executive officer of the International Brotherhood of Teamsters, Local #25 in Charlestown.

Term expires 2000.

Lucy A. Flynn is senior vice president, marketing and communications, for Wang Laboratories in Billerica.

Term expires 2003.

Robert H. Marsh is government affairs manager, Northeastern Region, American Automobile Manufacturers Association in Boston.

Term expires 2004.

Report of Independent Accountants

To the Members of the Massachusetts Port Authority:

In our opinion, the accompanying balance sheet and the related statements of income, changes in fund equity and cash flows present fairly, in all material respects, the financial position of the Massachusetts Port Authority (a public instrumentality of the Commonwealth of Massachusetts) at June 30, 1998 and the result of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles. We previously audited and reported upon the financial statements of the Authority for the year ended June 30, 1997 for which condensed statements are presented for comparison purposes only. These financial statements are the responsibility of the Authority's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

Boston, Massachusetts
September 8, 1998

Balance Sheets

June 30, 1998 with comparative totals for June 30, 1997

(in thousands)

ASSETS	Port Authority Operations	PFC Program	1998 Combined	1997 Combined
Cash and cash equivalents (Notes A and C)	$ 13,210	$ —	$ 13,210	$ 9,694
Investments (Notes A and C)	18,608	—	18,608	18,596
Accounts receivable, net of allowance for doubtful accounts of $11,920 and $11,165 in 1998 and 1997, respectively	31,089	886	31,975	23,567
Accounts receivable - grants (Note A)	1,839	—	1,839	210
Prepayments and other assets, net	37,976	—	37,976	21,626
Assets whose use is limited, including cash and cash equivalents of $35,789 and $50,727 in 1998 and 1997, respectively (Notes A, C, E and H)	339,737	55,464	395,201	330,527
Investment in facilities (Notes A, D and I):				
Completed facilities	1,566,328	9,705	1,576,033	1,504,024
Less accumulated depreciation	(727,065)	(763)	(727,828)	(674,931)
	839,263	8,942	848,205	829,093
Construction in progress	211,036	95,385	306,421	185,969
Net investment in facilities	1,050,299	104,327	1,154,626	1,015,062
Total Assets	$1,492,758	$160,677	$1,653,435	$1,419,282

LIABILITIES AND FUND EQUITY	Port Authority Operations	PFC Program	1998 Combined	1997 Combined
Liabilities				
Accounts payable and accrued expenses (Note H)	$ 46,469	$ 3,143	$ 49,612	$ 73,974
Accrued compensated absences (Note A)	11,000	—	11,000	10,612
Accrued pension cost (Note G)	—	—	—	640
Accrued interest payable	18,625	—	18,625	14,818
Funded debt (Notes F and M)	734,533	—	734,533	559,737
Deferred income (Note A)	18,392	—	18,392	3,198
Total Liabilities	829,019	3,143	832,162	662,979
Contingent liabilities and commitments (Notes I, K & L)				
Fund Equity (Notes A and B)				
Accumulated fund equity	528,709	157,534	686,243	628,987
Contributed capital, grants-in-aid of construction	135,030	—	135,030	127,316
Total Fund Equity	663,739	157,534	821,273	756,303
Total Liabilities and Fund Equity	$1,492,758	$160,677	$1,653,435	$1,419,282

The accompanying notes are an integral part of these financial statements.

Statements of Income

For the year ended June 30, 1998, with comparative totals for the year ended June 30, 1997

(In thousands)

	1998 Port Authority Operations	1998 PFC Program	1998 Combined	1997 Combined
Operating Revenues (Note B):				
Tolls, fees and sales of service	$158,007	$ —	$158,007	$142,460
Rentals (Note L)	64,874	—	64,874	61,974
Concessions (Note L)	43,654	—	43,654	38,031
Other	11,429	—	11,429	9,444
Total Operating Revenues	277,964	—	277,964	251,909
Operating Expenses (Note B):				
Operations and maintenance	114,197	—	114,197	108,355
Administration	49,889	—	49,889	50,068
Insurance (Note A)	2,414	—	2,414	2,646
Pension costs (Note G)	2,588	—	2,588	2,070
Payments in lieu of taxes (Note J)	12,062	—	12,062	10,526
Provision for uncollectible accounts	815	—	815	577
Total Operating Expenses	181,965	—	181,965	174,242
Depreciation and amortization, including $8,192 and $7,456 in 1998 and 1997, respectively, on assets acquired with contributed capital, grants-in-aid of construction (Notes A and D)	60,018	388	60,406	52,179
Income/(loss) from Operations	35,981	(388)	35,593	25,488
Gain on sale of assets	577	—	577	384
PFC Revenue (Notes A and E)	—	33,874	33,874	32,266
Financial income and expense:				
Income on investments (Note A)	15,060	3,748	18,808	15,614
Interest expense (Notes A and F)	(33,701)	—	(33,701)	(31,435)
Income before extraordinary item	17,917	37,234	55,151	42,317
Extraordinary item: Termination of interest rate swap (Note F)	(6,087)	—	(6,087)	—
Net Income	$ 11,830	$37,234	$ 49,064	$ 42,317

The accompanying notes are an integral part of these financial statements.

Statements of Changes in Fund Equity

For the years ended June 30, 1998 and 1997

(In thousands)

	Accumulated Fund Equity	PFC Program	Contributed Capital, Grants-in-aid of Construction	Total Fund Equity
Balance, June 30, 1996	$494,994	$ 84,220	$123,520	$702,734
Net income	6,237	36,080	—	42,317
Contributed capital, grants-in-aid of construction (Note A)	—	—	11,252	11,252
Transfer of depreciation to contributed capital	7,456	—	(7,456)	—
Balance, June 30, 1997	508,687	120,300	127,316	756,303
Net income	11,830	37,234	—	49,064
Contributed capital, grants-in-aid of construction (Note A)	—	—	15,906	15,906
Transfer of depreciation to contributed capital	8,192	—	(8,192)	—
Balance, June 30, 1998	$528,709	$157,534	$135,030	$821,273

The accompanying notes are an integral part of these financial statements.

Statements of Cash Flows

For the years ended June 30, 1998 and 1997

(In thousands)

	1998	1997
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from customers	$283,932	$248,378
Cash payments:		
To vendors for goods and services	(98,746)	(96,808)
To employees for services	(68,851)	(67,559)
Payments in lieu of taxes	(12,062)	(10,526)
Net cash provided by operating activities	104,273	73,485
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Grants-in-aid of construction	14,277	17,329
Acquisition and construction of capital assets	(203,573)	(95,379)
Proceeds from sale of bonds	537,515	—
Proceeds from sale of equipment	718	445
Principal paid on refunded debt	(303,195)	—
Principal paid on funded debt	(64,620)	(12,855)
Interest paid on funded debt	(42,303)	(35,784)
Termination of interest rate swap	(6,087)	—
Proceeds from passenger facility charges	35,137	32,344
Net cash used in capital and related financing activities	(32,131)	(93,900)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(4,445,041)	(2,510,980)
Proceeds from sale and maturities of investments	4,338,935	2,475,523
Interest earned on investments	22,542	17,354
Net cash used in investing activities	(83,564)	(18,103)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(11,422)	(38,518)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	60,421	98,939
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 48,999	$ 60,421

The accompanying notes are an integral part of these financial statements.

Statements of Cash Flows, continued

For the years ended June 30, 1998 and 1997

(In thousands)

	1998	1997
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net income	$ 49,064	$ 42,317
Less:		
income on investments	(18,808)	(15,614)
proceeds from passenger facility charge	(33,874)	(32,266)
gain on sale of equipment	(577)	(384)
Add:		
interest expense	33,701	31,435
termination of interest rate swap	6,087	—
	$ 35,593	$ 25,488
ADJUSTMENTS TO RECONCILE INCOME FROM OPERATIONS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Depreciation and amortization	60,406	52,179
Provision for uncollectible accounts	815	577
Change in assets and liabilities:		
Increase in accounts receivable	(10,486)	(2,285)
Decrease/(Increase) in prepayments and other assets	26,318	(4,662)
(Decrease)/Increase in accounts payable and accrued expense	(23,315)	3,828
Increase/(Decrease) in accrued compensated absences	388	(365)
Decrease in accrued pension cost	(640)	(604)
Increase/(Decrease) in deferred income	15,194	(671)
Total adjustments	68,680	47,997
NET CASH PROVIDED BY OPERATING ACTIVITIES	$104,273	$ 73,485

The accompanying notes are an integral part of these financial statements.

The Massachusetts Port Authority (the Authority) is a quasi-governmental public instrumentality created by an act of the Legislature (the Enabling Act) of the Commonwealth of Massachusetts (the Commonwealth), effective June 21, 1956. The Authority controls, operates and manages Boston-Logan International Airport (Logan Airport), Hanscom Field, Maurice J. Tobin Memorial Bridge (Tobin Bridge) and facilities in the Port of Boston. The Authority has no stockholders or equity holders.

The provisions of the Enabling Act and the 1978 Trust Agreement (the Trust Agreement), as amended, with the Authority's bondholders govern the disposition of cash revenues to the various funds established under the Trust Agreement and restrict the use of such revenues credited to the various funds.

Notes to Financial Statements, continued

A. Summary of Significant Accounting Policies:

These financial statements have been prepared in conformity with generally accepted governmental accounting principles.

The Authority has elected not to follow Financial Accounting Standards Board Statements and interpretations issued after November 30, 1989 as allowed per the Governmental Accounting Standards Board.

(1) Assets Whose Use Is Limited
The balance sheet caption, "assets whose use is limited," represents restricted or trusteed assets under the Trust Agreement that are earmarked to fund certain activities of the Authority such as construction of new facilities and debt service.

(2) Cash and Cash Equivalents
For purposes of the statements of cash flows, the Authority considers all highly liquid investments (including assets whose use is limited) with an original maturity of 30 days or less when purchased to be cash equivalents.

(3) Investments
Investments in U.S. Government securities are recorded at amortized cost plus accrued interest, which approximates market value. Investments in repurchase agreements are recorded at cost plus accrued interest, which also approximates market value.

(4) Self-Insurance
The Authority, as mandated by the Trust Agreement, maintains a self-insurance account within the operating fund. The Authority is self-insured for certain major catastrophic risks and worker's compensation claims, but maintains insurance coverage for claims in excess of established limits. Investments used to fund self-insurance claims are included within "assets whose use is limited" in the accompanying balance sheets. (See Notes C and K).

(5) Investment in Facilities
Facilities are carried at historical cost and include the expenditure of federal grants-in-aid of construction and the cost of significant renewals and betterments. Federal grants-in-aid of construction are recorded as contributed capital as earned and amortized on the straight-line method over the service lives of the related assets. Expenditures for repairs and maintenance are charged to expense as incurred.

(6) Depreciation
Depreciation is provided on the straight-line method based on estimated useful service lives of the related assets beginning in the fiscal year of acquisition or upon completion of construction. Depreciation is computed on facilities which are recorded in the accounts of the Authority, including those financed by grants-in-aid of construction.

(7) Interest Capitalization
The Authority capitalizes certain interest associated with the cost of restricted tax-exempt borrowings, less any interest earned on temporary investment of the proceeds of those borrowings during the period of construction. Interest expense of $12,410,000 and $4,102,000 reduced by interest income of $4,094,000 and $2,169,000 for the years ended June 30, 1998 and 1997, respectively, has been capitalized as a part of the cost of construction projects.

(8) Accounting for Compensated Absences
The Authority accrues for vacation and sick pay when it is earned. The liability for vested vacation and sick pay is reflected in the accompanying balance sheets under the caption "accrued compensated absences."

(9) Deferred Income
Deferred income consists primarily of amounts received from the Massachusetts Highway Department (MHD) for temporary and permanent easements of certain properties at Logan Airport which provide MHD with sufficient rights in land owned by the Authority to permit MHD to complete the Ted Williams Tunnel project, as currently designed. Income received from these easements will be recognized over the shorter of the assets' useful life or the original lease term for temporary easements and over the estimated useful life of the assets contracted under permanent easements which is estimated at 25 years.

(10) Passenger Facility Charges
Revenues derived from the collection of passenger facility charges (PFCs) are recognized and reported as non-operating revenue by the Authority.

B. Revenues and Operating Expenses as Determined by Accounting Practices Prescribed by the Trust Agreement:

The provisions of the Enabling Act and the Trust Agreement with State Street Bank and Trust Company, as trustee for the benefit of the Authority's bondholders, prescribe certain accounting practices to be followed in maintaining the accounts and records of the Authority.

Under the Trust Agreement, monthly cash revenues of the Authority are deposited in the Operating Fund. After providing for operating expenses, including pension expense and transfers to the self-insurance account, cash revenues are then transferred to the Interest and Sinking Fund, which are applied to debt service on any outstanding bonds, the Maintenance Reserve Fund, the Payment In Lieu of Taxes Fund, and if applicable, the Capital Budget Fund and finally the Improvement and Extension Fund. Cash and investments held in the Improvement and Extension Fund, to the extent designated by the Authority, are deposited in the Capital Budget Account within such fund.

During fiscal 1998, the Authority redeemed its revenue refunding bonds, Series 1978. Accordingly, the terms and conditions regarding the recording of pledged revenues in the 1978 pledged revenue sub-account of the revenue fund mandated by that bond issue are no longer necessary. Prior to fiscal 1998, under the provisions of the Trust Agreement, all revenues derived from operation of the Tobin Bridge, all aircraft landing fees and motor vehicle parking fees, derived from the operations of the airport properties, and all income from investments held in all funds with the exception of the Construction Funds, Port Properties Fund and self-insurance account are pledged for the debt service requirements of the Revenue Refunding Bonds, Series 1978.

Notes to Financial Statements, Continued

B. Revenues and Operation Expenses as Determined by Accounting Practices prescribed by the Trust Agreement, *continued:*

Presented below are the revenues and operating expenses as determined in accordance with the Trust Agreement and a reconciliation to net income as presented in the accompanying Statements of Income under generally accepted governmental accounting principles (GAGAP).

(In thousands)	Bridge	Airport Properties	Port Properties Maritime	Port Properties Development[6]	Income on Investments	1998 Total	1997 Total
Revenues, Net:							
Pledged Revenues	$12,486	$236,833	$22,354	$5,476	$13,738	$290,887	$261,456
Passenger Facility Charge (Note E)	—	33,874	—	—	3,748	37,622	36,455
Total	12,486	270,707	22,354	5,476	17,486	328,509	297,911
Operating Expenses:							
Operations and Maintenance	4,232	84,937	21,394	3,102	—	113,665	108,329
Administration	2,036	38,300	6,891	2,662	—	49,889	50,068
Insurance	284	1,901	507	198	—	2,890	3,265
Pension (Note G)	187	2,554	375	112	—	3,228	2,674
Total	6,739	127,692	29,167	6,074	—	169,672	164,336
Excess (Deficit) of Revenues Over Operating Expenses Under Trust Agreement	5,747	143,015	(6,813)	(598)	17,486	158,837	133,575
Add: Self-Insurance Cost (1)	29	350	62	35	—	476	619
Pension Adjustment (1)	27	512	77	24	—	640	604
Self-Insurance Income on Investments (3)	—	—	—	—	1,322	1,322	1,213
Less: Payments In Lieu of Taxes (4)	(443)	(10,154)	(999)	(466)	—	(12,062)	(10,526)
Gain on Sale of Equipment (2)(3)	—	573	4	—	—	577	384
Other (4)	—	(532)	—	—	—	(532)	62
Interest Expense (4)	(3,674)	(23,438)	(5,249)	(1,340)	—	(33,701)	(31,435)
Depreciation and Amortization (4)	(3,950)	(42,052)	(9,348)	(5,056)	—	(60,406)	(52,179)
Termination of interest rate swap (4)	—	(6,087)	—	—	—	(6,087)	—
Net Income (Loss)	($ 2,264)	$ 62,187	($22,266)	($7,401)	$18,808	$ 49,064	$ 42,317

(1) Expensed under Trust Agreement, not an expense under GAGAP.

(2) Equipment is depreciated under GAGAP but not under Trust Agreement.

(3) Not revenue under Trust Agreement, revenue under GAGAP.

(4) Not operating income/(expense) under Trust Agreement, income/(expense) under GAGAP.

(5) For Trust accounting purposes, the provision for uncollectible accounts is netted within the accounts listed under the revenues caption.

(6) Development includes activities related to the Authority's Commonwealth, Fish and Hoosac Piers.

Notes to Financial Statements, continued

C. Cash, Cash Equivalents and Investments:

The following summarizes the Authority's cash, cash equivalents and investments at June 30, 1998 by the various funds and accounts established under the Trust Agreement with the Authority's bondholders. Summary 1997 information is also presented. (Assets designated for credit enhancement and deferred compensation are also included.)

(in thousands) **Use defined for specific purposes:**	Cash and Cash Equivalents	Investments	Assets whose use is limited Cash, Cash Equivalents & Investments	1998 Total	1997 Total
1978 Debt Service Fund	$ —	$ —	$ —	$ —	$ 42,286
Revenue Fund	—	—	11,327	11,327	—
Operating Fund	3,128	—	—	3,128	3,839
Self-Insurance Account	—	—	23,970	23,970	22,219
Maintenance Reserve	—	—	34,343	34,343	32,250
Payments In Lieu of Taxes	—	—	7,459	7,459	7,179
Capital Budget	—	—	111,591	111,591	48,617
Improvement and Extension Fund	10,082	18,608	—	28,690	24,451
1990 Interest and Sinking Fund	—	—	8,510	8,510	12,578
1992 Interest and Sinking Fund	—	—	7,516	7,516	11,075
1993 Interest and Sinking Fund	—	—	13,970	13,970	13,991
1995 Interest and Sinking Fund	—	—	—	—	10,557
1997A Interest and Sinking Fund	—	—	14,508	14,508	—
1997B Interest and Sinking Fund	—	—	4,337	4,337	—
1998A Interest and Sinking Fund	—	—	12,407	12,407	—
1998B Interest and Sinking Fund	—	—	6,290	6,290	—
1998C Interest and Sinking Fund	—	—	25,647	25,647	—
1993 Project Fund	—	—	—	—	23
1995 Project Fund	—	—	—	—	22
1996 Project Account	—	—	—	—	25,724
1996B Project Account	—	—	3,017	3,017	—
1997 Note Project Account	—	—	877	877	—
1997A Project Account	—	—	39,892	39,892	—
1997B Project Account	—	—	4,909	4,909	—
1998 Refunding Project Account	—	—	171	171	—
Credit Enhancement Account (Note I)	—	—	8,996	8,996	9,541
PFC Accounts	—	—	55,464	55,464	67,983
Subtotal	13,210	18,608	395,201	427,019	332,335
Deferred Compensation (Note H)	—	—	—	—	26,482
Total	$13,210	$18,608	$395,201	$427,019	$358,817

The carrying amount of the Authority's cash deposits was $4,519,000 and $4,334,000 at June 30, 1998 and 1997, respectively. The bank balance was $13,099,000 and $8,100,000 at June 30, 1998 and 1997, respectively. The nature of the reconciling items between the book and bank balance consisted primarily of outstanding checks which had not cleared the bank at year-end. The bank balance was fully collateralized as of June 30, 1998 and 1997.

Notes to Financial Statements, Continued

C. Cash, Cash Equivalents and Investments, *continued:*

The following summarizes the Authority's cash and cash equivalents and investments by type held at June 30, 1998, excluding cash and investments held for purposes of deferred compensation ($0 and $26,482,000 at June 30, 1998 and 1997 respectively, see note H). Summary 1997 information is also presented.

(in thousands)	Carrying Amount	Market Value
Certificates of Deposit	$ 101	$ 101
Repurchase Agreements	163,703	163,704
U.S. Government Securities:		
Treasury Notes	6,634	6,676
Federal Farm Credit (FFC)	7,328	7,298
Federal Farmer Mortgage (FRM)	15,469	15,469
Federal National Mortgage Association (FNMA)	97,366	97,045
Federal Home Loan Bank (FHLB)	44,927	44,894
Federal Home Loan Mortgage Corp. (FHLMC)	86,820	86,755
Total U.S. Government & Agency Securities	258,544	258,137
Fidelity U.S. Treasury Income Portfolio Mutual Fund and Others	152	152
Total investments	422,500	422,094
Cash deposits	4,519	4,519
Total at June 30, 1998	$427,019	$426,613
Total at June 30, 1997	$332,335	$332,482

The Authority is authorized by the Trust Agreement to invest in obligations of the U.S. Treasury, U.S. Government agencies and instrumentalities, in bonds or notes of public agencies or municipalities, in bank time deposits and in repurchase agreements. All investments are held on behalf of the Authority by the Authority's trustee and custodian.

The Certificates of Deposit are fully insured by the Federal Deposit Insurance Corporation. Repurchase agreements are collaterized by obligations of the U.S. Government or agencies of the U.S. Government. The Trust Agreement requires that securities underlying repurchase agreements at the time of purchase must have a market value at least equal to the cost of the agreement plus accrued interest.
The Fidelity U.S. Treasury Income Portfolio Mutual Fund is held by the Authority in accordance with the Credit Enhancement Agreement (see footnote I) and is not guaranteed by the U.S. Government.

Notes to Financial Statements, Continued

D. Investment in Facilities and Depreciation:

Net investment in facilities at June 30, 1998 and 1997 is comprised of:

(In thousands)	**1998**	**1997**
Facilities completed by operation:		
Airport	$1,083,898	$1,022,652
Bridge	116,546	116,235
Port	375,589	365,137
Investment in facilities	$1,576,033	$1,504,024
Facilities completed by type:		
Land and land improvements	$ 112,323	$ 113,033
Bridge and bridge improvements	110,837	110,822
Buildings	903,211	876,014
Runways and other paving	367,582	325,154
Machinery and equipment	82,080	79,001
	1,576,033	1,504,024
Accumulated depreciation and amortization	(727,828)	(674,931)
	848,205	829,093
Construction in progress	306,421	185,969
Net investment in facilities	$1,154,626	$1,015,062

Estimated useful lives used in the calculation of depreciation are as follows:

Bridge	*100 years*
Bridge improvements	*10 and 25 years*
Airport facilities - buildings, runways and other paving	*10 and 25 years*
Port facilities - buildings and piers	*25 years*
Machinery and equipment	*5 and 10 years*

Notes to Financial Statements, Continued

E. Passenger Facility Charges:

In 1993, the Authority received approval from the Federal Aviation Administration (FAA) to impose a $3.00 passenger facility charge (PFC) at Logan Airport. PFCs collected by the Authority are an amount in lieu of Federal grants and can be used for capital projects determined by the FAA to be eligible in accordance with the Aviation Safety and Capacity Expansion Act of 1990. The Authority was authorized to collect net PFCs up to $598.8 million for the period of November 1, 1993 through October 1, 2011.

In January 1997, the Authority received approval from the Federal Aviation Administration (FAA) to increase its collections up to $631.8 million with a projected expiration date of September 1, 2012. The Authority also received approval from the FAA to use or expend a total of $493.2 million for preliminary design projects as well as for the final design, construction and financing costs associated with the eligible portions of residential soundproofing, Terminal E Modernization, circulating roadways and the elevated walkways.

In February 1998, the Authority received approval from the Federal Aviation Administration (FAA) to increase its collections up to $927.4 million with a projected expiration date of October 1, 2017. The Authority also received approval to use or expend $434.1 million for the final design, construction and financing costs associated with the eligible portions of the International Gateway Project.

The amount of PFC revenue invested in Port Authority facilities, operations and reserves that are restricted for future PFC project payments is as follows:

	June 30, 1998 *(in thousands)*
Total assets, PFCs	$160,677
PFC funds expended on approved projects	(105,090)
PFCs restricted but not yet expended	$ 55,587

F. Funded Debt:

The following is a summary of the Authority's funded debt activity for the years ended June 30, 1998 and 1997:

(in thousands)	**1998**	**1997**
Funded debt, beginning of year	$569,185	$582,040
Debt refinanced	(303,195)	—
New debt issued	537,515	—
Principal paid on funded debt	(64,620)	(12,855)
Funded debt, end of year	$738,885	$569,185

Funded debt at June 30, 1998 and 1997 is comprised of the following:

(in thousands)	**Weighted Average Interest Rate at June 30, 1998**	**1998**	**1997**
Revenue Refunding Bonds			
Series 1978		$ —	$ 6,305
Series 1993 - A & B	5.2%	49,200	51,885
Series 1995 - A & B	—	—	70,080
Series 1997 - C	4.8%	15,040	—
Series 1998 - A, B & C	5.8%	266,915	—
Revenue Bonds			
Series 1990 - A	7.1%	11,480	16,975
Series 1992 - A & B	5.5%	19,445	20,905
Series 1997 - A	5.1%	68,185	—
Series 1997 - B	5.0%	21,125	—
Term Revenue Bonds	5.6%	238,495	352,035
Commercial Paper	3.6%	49,000	51,000
Total Funded Debt		738,885	569,185
Less: Unamortized loss on refunding		(342)	(1,417)
Less: Original issue discount		(4,010)	(8,031)
Total		$734,533	$559,737

Scheduled principal payments on funded debt are due annually July 1 as follows:

Fiscal Year	**Amount** *(in thousands)*
1999	$ 68,460
2000	20,505
2001	21,605
2002	22,875
2003	24,110
Thereafter	581,330
Total	$738,885

Notes to Financial Statements, Continued

F. Funded Debt, *continued:*

On August 7, 1997, the Authority issued $140,465,000 in Revenue Bonds, Series 1997-A to fund the construction of the West Garage, Central Garage Modifications, Logan Roadway Betterments and various airfield improvements, as well as $19,330,000 in Revenue Refunding Bonds, Series 1997-C that advance refunded a portion of the outstanding Revenue Bonds, Series 1990-A.

On August 21, 1997, the Authority issued $43,730,000 in Revenue Bonds, Series 1997-B to fund the construction of the non-PFC portion of the Terminal E Modernization, electrical upgrades to serve the needs of Logan Modernization, the completion of the BIF garage, and Cargo Building No. 63.

On January 29, 1998, the Authority issued $104,660,000 in Revenue Refunding Bonds, Series 1998-A, $47,610,000 in Revenue Refunding Bonds, Series 1998-B, and $132,720,000 in Taxable Revenue Refunding Bonds, Series 1998-C that refunded all of the Authority's outstanding Revenue Refunding Bonds, Series 1978, and all of the Authority's outstanding Multi-Modal Revenue Bonds, Series 1995-A and Series 1995-B and a portion of the outstanding Revenue Bonds, Series 1990-A, Series 1992-A and Series 1992-B.

The refunding of the 1978 Bonds, the 1990-A Bonds, the 1992-A Bonds, the 1992-B Bonds, the 1995-A Bonds, and the 1995-B Bonds resulted in a difference between the reacquisition price and the net carrying amount of the old debt of approximately $7,368,000. This difference has been capitalized in the accompanying financial statements and is being charged to operations over the life of the 1997 and 1998 bonds as appropriate, using the straight line method. As a result of the refunding, the Authority will reduce its aggregate debt service payments by approximately $35,610,000 and achieve an economic gain (the difference between the present value of the old and new debt service payments) of approximately $17,020,000.

In fiscal 1993, the Authority entered into a forward interest rate swap arrangement in the initial notional amount of $71,715,000 which took effect July 1, 1995 for the seven-year period ending June 30, 2002, with a portion continuing through January 1, 2003. Under this arrangement, the Authority paid interest at 6.405% per annum and received interest at a floating rate. As a result of the Series 1998 A, B, and C refunding, the Authority terminated the swap agreement. This termination required the Authority to pay the counterparty to the swap agreement $6,087,000, which was substantially equal to the present value of the Authority's remaining obligations under the swap arrangement. This termination payment is being recorded as an extraordinary item in the accompanying financial statements.

In March 1997, the Board authorized the extension of the 1996 commercial paper program for another year by extending the Letter of Credit with Canadian Imperial Bank of Commerce ("CIBC"), the dealer agreement with J.P. Morgan and the paying agent agreement with Bankers Trust Company. In July 1997, the Board voted to increase the commercial paper program and the associated Letter of Credit with CIBC to $80 million, and to offer both a non-AMT program (called the 1996 Series) and an AMT series (called the 1997 Series). In June 1998, the Board again voted to increase the commercial paper program to up to $100 million in the aggregate and to enter into a three-year Letter of Credit with Westdeutsche Landesbank Girozentrale, acting through its New York Branch, and terminate the Letter of Credit with CIBC. The sum of the two programs will not exceed the lesser of 10% of the outstanding principal on the Authority's outstanding debt or $100 million. As of June 30, 1998, $49 million in commercial paper is outstanding, representing $20 million in Series 1996 and $29 million in Series 1997 Commercial Paper.

In prior years, the Authority defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust with the Trustee for such bonds to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Authority's financial statements. At June 30, 1998, the following bonds are considered defeased:

(in thousands)	
1964 Series	$ 20,585
1969 Series	37,825
1971 Series	52,045
1973 Series	72,585
1982 Series	48,120
Total Defeased Bonds	$231,160

G. Pension Costs:

In July 1978, the Massachusetts legislature passed legislation which was enacted as Chapter 487 of the Massachusetts Acts of 1978 ("C. 487") and signed into law on July 18, 1978. This act provided for the establishment of the "Massachusetts Port Authority Employees' Retirement System" (the Plan), a contributory retirement system that is separate from the Massachusetts State Employees' Retirement System. Prior to this enactment, Authority employees were members of the state employees' system, and the funding of the pension liability was on a "pay as you go" method. Pursuant to C.487 the employees' rights and benefits under the state plan were transferred to the new system, and the Authority established a separate pension fund. The Single Employer Plan was established to provide retirement benefits for substantially all employees of the Authority and incidental benefits for their surviving spouses, beneficiaries and contingent annuitants. The Plan is a contributory defined benefit plan to which the Authority and its employees contribute such amounts as are necessary, on an actuarial basis, to provide assets sufficient to meet benefits to be paid to Plan participants.

At January 1, 1998, the Plan's membership consisted of:

Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits but not yet receiving them	327
Current Members:	
Active	1,138
Inactive	53
Total	1,518

Benefits are paid by the Plan from net assets available for plan benefits. Plan participants are entitled at normal retirement date to benefit payments based upon length of service and earnings levels. Vesting occurs after 10 years of service. Optional payment methods may be elected, including the contingent annuitant method which provides for reduced payments during the life of the plan participant and continued payments to the participant's beneficiary after the death of the participant.

The Authority funds pension costs based on the actuarially determined annual pension expense which includes current service cost and the amortization, over a 20-year period, of unfunded prior service costs. This annual pension contribution, as actuarially determined, includes a factor for the reimbursement to the Commonwealth for amounts expended by the Commonwealth on account of the Authority's employees retired prior to January 1, 1979.

The Authority's covered payroll for members of the Plan as of the most recent actuarial valuation dates was approximately $54,393,000 as of January 1, 1998. Total payroll for Authority employees was approximately $63,587,000 for the 12 months ended June 30, 1998.

The actuarial cost method utilized to determine contributions to the Plan for the years ended December 31, 1997 and 1996 is the entry age normal-frozen initial liability cost method.

G. Pension Costs, continued:

The more significant actuarial assumptions underlying the actuarial computations for the years ended December 31, 1997 and 1996 are as follows:

Assumed rate of return on investments	8.0% per annum compounded annually
Nondisabled life mortality basis	1983 Group Annuity Table for males with females set back six years
Withdrawal prior to retirement	The rates shown at the following sample ages illustrate the withdrawal assumption

Rate of Withdrawal

Age	Group 1 and 2	Group 4
25	9.0%	1.8%
30	5.6%	1.7%
35	3.2%	1.3%
45	1.8%	.1%
50	1.5%	N/A
55	N/A	N/A

Salary escalation	5.5% per annum
Rates of retirement	Group 1 and 2 employees are assumed to retire at the later of 63 and 10 years of service Group 4 employees are assumed to retire at the later of age 56 and 10 years of service
Retirement benefits	2.3% per year of service for Group 1, 2.5% per year of service for Group 2 and Group 4
Postretirement cost of living increases	3% per annum compounded annually on the first $9,000 of pension benefits for 1997 and 1996

The amount shown below as "actuarial accrued liability (surplus)" (AAL) is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future as a result of employee service to date. The measure is the actuarial present value of credited projected benefits and is intended to help users assess the Plan's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among other Public Employee's Retirement Systems Plans.

G. Pension Costs, *continued:*

At January 1, 1998, the unfunded actuarial accrued liability (surplus) was ($197,345,304) determined as follows:

(in thousands)	
Total actuarial accrued liability	$ 5,415
Actuarial value of assets	202,761
Unfunded actuarial accrued liability (surplus)	($197,346)

The Plan's funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are adequate to accumulate sufficient assets to pay benefits when due and fund operating costs of the Plan. The Plan also amortizes the unfunded liability in level amounts over a period of 20 years.

Total contributions to the Plan were $7,675,836 for the Plan year ended December 31, 1997. This includes employee contributions of $4,447,839 which are based upon a percentage of employee base pay (5% for employees hired before December 31, 1974, 7% for employees hired between January 1, 1975 and December 31, 1983, 8% for employees hired after December 31, 1983 and 9% for employees hired after July 1, 1996 and, effective January 1, 1988, an additional 2% of base pay over $30,000 for those employees hired after December 31, 1978) and employer contributions of $3,227,997 which were made in accordance with actuarially determined contribution requirements determined through an actuarial valuation performed for the Plan's fiscal year beginning January 1, 1997. Employer contributions consisted of (a) $1,352,088 normal cost, (b) $1,875,909 amortization of the unfunded actuarial accrued liability (surplus).

G. Pension Costs, *continued:*

The information presented in the following schedules was determined as part of the actuarial valuation at January 1, 1998.

SCHEDULING OF FUNDING PROGRESS *(in thousands)*

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (Surplus) (b - a)	Funded Ratio % (a / b)	Covered Payroll	UAAL as a percent of Covered Payroll % (b - a) / c
1/1/98	$202,761	$ 5,415	$ 0	3,744	$54,393	0
1/1/97	175,804	3,651	0	4,815	50,563	0
1/1/96	158,403	1,863	0	8,504	49,193	0
1/1/95	134,981	2,813	0	4,799	44,496	0
1/1/94	126,496	10,999	0	1,150	38,476	0
1/1/93	110,432	2,592	0	4,261	40,380	0

Analysis of the dollar amounts of actuarial value of assets, AAL and UAAL, in isolation, can be misleading. Expressing the actuarial value of assets as a percentage of the AAL provides one indication of the Plan's funding status on a going-concern basis. Analysis of this percentage over time indicates whether the system is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the Public Employee Retirement System (PERS). Trends in assets in excess of AAL and annual covered payroll are both affected by inflation. Expressing the assets in excess of AAL as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of progress made in accumulating sufficient assets to pay benefits when due.

SCHEDULE OF EMPLOYER CONTRIBUTIONS *(in thousands)*

Calendar Year Ended 12/31	Annual Required Employer Contributions (ARC)	Employer Contributions as a percent of ARC
1997	$3,228	100%

The Plan's financial statements have been prepared in accordance with generally accepted accounting principles applicable to governmental units.

Plan investments are valued according to accounting policies adopted by the Trustee. Common stocks traded on national exchanges are valued at the last reported sales price. U.S. Government and corporate bonds are stated at cost adjusted, as applicable, for amortized discounts and premiums. The Plan's investment in venture capital limited partnerships are accounted for using the cost method.

Certain operating expenses incurred by the Plan are funded by the Authority through additional employer contributions. Investment management fees, consulting fees and custodial fees for the Plan are reflected as deductions to investment income.

For the financial statements prepared in accordance with generally accepted governmental accounting principles, pension expense includes current service cost and amortization of past service costs which were determined as of July 1, 1973, over a 25-year period, commencing in 1974.

Total pension expense so determined was $2,588,000 and $2,070,000 for the years ended June 30, 1998 and 1997, respectively.

H. Deferred Compensation:

The Authority offers its employees a deferred compensation plan (the "Plan") created in accordance with Internal Revenue Code Section 457. The Plan, available to all Authority employees, permits them to defer a portion of their salary until future years.

Prior to fiscal year 1998, amounts of compensation deferred under the Plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights were (until paid or made available to the employee or other beneficiary) solely the property and rights of the Authority (without being restricted to the provisions of benefits under the Plan), subject only to the claims of the Authority's general creditors. Participants' rights under the Plan were equal to those of general creditors of the Authority in an amount equal to the fair market value of the deferred amount for each participant.

Effective December 31, 1997, Section 457 of the Internal Revenue Code was amended by Section 1448 of the Small Business Job Protection Act of 1996 which provides that governmental deferred compensation plans must hold all assets and income of the plan in trust for the exclusive benefit of participants and their beneficiaries.

The market value of the deferred compensation plan assets and the total amount of deferred compensation, including income earned, were approximately $33,475,000 and $26,482,000 at June 30, 1998 and 1997, respectively. In accordance with the legislation described above, the assets and associated liability of the deferred compensation plan assets for June 1998 are not included in the Authority's balance sheets. The market value of such assets and liabilities for June 1997 were included in the accompanying balance sheets under the captions "assets whose use is limited" and "accounts payable and accrued expenses, respectively."

I. Contingent Liabilities and Commitments:

Contractual Obligations for Construction:
Contractual obligations for construction were approximately $93,858,000 at June 30, 1998.

Credit Enhancement Agreement:
During fiscal 1991, the Authority entered into a Credit Enhancement Agreement in connection with an unrelated partnership's bond issuance. The bonds were issued to provide financing to the partnership (the Borrower) for construction, which was completed in fiscal 1993, of a conference center and hotel located at Logan Airport. The Credit Enhancement Agreement September 1, 1998 represents a guarantee by the Authority to pay bondholders up to $9.0 million, in the event the Borrower does not have sufficient funds (as defined) to meet its debt service requirements.

In the opinion of the Authority's management, no advance against the Credit Enhancement Agreement is anticipated during the next 12 months. However, any such advance, then taking the form of a loan from the Authority to the Borrower, would bear interest at 10%.

Third Harbor Tunnel:
The Massachusetts Highway Department ("MHD") is undertaking a depression of a portion of I-93 in downtown Boston ("Central Artery") and the extension of the eastern terminus of I-90 to the Airport by construction of a new tunnel under Boston Harbor (the "Ted Williams Tunnel"), (collectively, the "CA/T Project").

Legislation has been enacted in order to address the construction, operation and financing of the CA/T Project, primarily Chapter 3 of the Acts of 1997, as amended by Chapter 11 of the Acts of 1997 (as so amended, "Chapter 3"). Chapter 3 mandates that the CA/T Project, upon completion of each segment thereof, be transferred to the Massachusetts Turnpike Authority (the "Turnpike Authority"). Among other things, Chapter 3 provides for the acquisition by the Authority of components or segments of the Metropolitan Highway System (the "MHS") pursuant to one or more agreements providing for (i) acquisition by the Authority of certain portions of the MHS, (ii) the assumption by the Authority of operation and maintenance responsibilities for the acquired properties, and (iii) a payment by the Authority to the Commonwealth of Massachusetts of $200 million, plus any additional payments (up to an additional $100 million) recommended by a joint asset assessment study (the "Study"), for acquisition of additional assets and annual contributions for operation and maintenance of designated portions of the MHS by the Authority to the Turnpike Authority, which may either be by direct payments or equivalent in-kind contributions. The Study, which has been finalized and submitted to the Governor and the Legislature, identifies segments of the MHS to be acquired by the Authority in exchange for which the Study recommends that the Authority make payments to the Commonwealth in an amount not to exceed $300 million (which amount includes the $200 million previously required by Chapter 3), in installments payable in fiscal 1998 through fiscal 2005, consistent with the payment schedule set forth in the MOU referred to below. The aggregate amount of such payments would be based upon the value of the roadway segments as determined in accordance with the valuation methodology set forth in the Study. The Authority, MHD and the Turnpike Authority are actively engaged in negotiating the final terms of an agreement which is expected to effectuate the recommendations of the Study. A payment schedule for $300 million is set forth in a memorandum of understanding between the Authority and the Commonwealth of Massachusetts acting through the Executive Office of Administration and Finance (the "MOU"). The payment schedule for the aggregate of $300 million of payments has been incorporated in the Authority's FY98-03 Capital Program as follows: $12.1 million, $30.7 million, $52.2 million, and $105 million for fiscal 1998, 1999, 2000, and 2003, respectively with an additional $50 million in each of fiscal 2004 and 2005, respectively. In September 1997, the Authority made its first installment of $12.1 million and this is reflected as a prepayment in the accompanying financial statements. Pursuant to Chapter 3 and the MOU, the Authority expects to enter into an Asset Transfer Agreement with the Turnpike Authority and MHD describing the assets to be transferred to and maintained by the Authority and the schedule of payments to be made by the Authority in consideration therefor. The payment schedule is expected to be consistent with the MOU.

I. Contingent Liabilities and Commitments, *continued:*

In consideration of their mutual desire to realize the long-term transportation benefits of the Ted Williams Tunnel and mutual commitment to ameliorate its impacts on the Authority's facilities, the Authority and MHD entered into a Sale/Mitigation Agreement on October 3, 1991 which sets the framework for land acquisitions by the MHD for the Tunnel Project.

The Authority and MHD have entered into a Settlement Agreement dated as of January 15, 1998 (the "CA/T Settlement Agreement") which is intended to resolve all past and certain future land acquisition claims relating to the portions of the Authority's property at the Airport and in South Boston necessary to complete the Ted Williams Tunnel project. Pursuant to the CA/T Settlement Agreement, MHD has agreed to make payments to the Authority and certain of its tenants and to provide certain betterments to the Authority. As of July 1, 1998, the Authority has received payments from MHD totaling approximately $27.2 million. In return, the Authority has released MHD from all pending land damage lawsuits and claims relating to the Ted Williams Tunnel project asserted by the Authority against MHD, to assist MHD with relocation of certain Airport tenants, to work diligently to cause certain tenants of the Authority to dismiss pending land damage actions against MHD, and to provide MHD with sufficient rights in land owned by the Authority at the Airport to permit MHD to complete the Ted Williams Tunnel project, as currently designed.

Seaport Bond Bill:

The Seaport Bond Bill was enacted on February 14, 1996 and provides authorization for funding by the Commonwealth of $15 million towards the non-federal share of the cost of completing the Boston Harbor Navigation Improvement Project, including without limitation: the cost of dredging the Authority's deep cargo berths; all costs associated with the preparation of the environmental studies and reports; and the costs related to the design and relocation of the MWRA pipeline in the Chelsea Creek. The Seaport Bond Bill requires the Authority to pay twenty-five percent (25%) of the non-federally funded costs of the Project. The Authority has already paid or committed approximately $5 million of the non-federal share of the Project. Independent berth owners have contributed approximately $500,000. A second provision of the Seaport Bond Bill would provide a mechanism for funding improvements to the Massachusetts rail transportation network allowing rail shipment of double stack cargo from the Allston yards in Boston to points west, which is anticipated to encourage expanded container shipments through the Port of Boston. The statute requires that the Authority provide up to fifty percent (50%) of the cost of improvements to the rail line from Framingham to the Allston yard in Boston permitting double stack shipments, at an estimated cost to the Authority of approximately $50 million. Expenditure of funds will not occur until the execution of a Master Agreement, as defined by the statute, between the Commonwealth and the participating railroads.

J. Payments In Lieu of Taxes:

The Enabling Act authorizes and directs the Authority, subject to certain standards and limitations, to enter into agreements (collectively, the "PILOT Agreements") to make annual payments in lieu of taxes to Boston, Chelsea, and Winthrop. In fiscal 1992, the Authority's obligation to Chelsea for annual in lieu of tax payments through 2012 was satisfied by a payment of $5 million. In response to increased traffic on the Bridge and the increased impact of the Airport on Chelsea since 1992, the Authority has recommended an increase in the in lieu of tax payments to be made to Chelsea.

In fiscal 1994, the Authority entered into an extension of an amendment to its agreement with Winthrop (the "Winthrop PILOT Agreement") which extended the base in lieu of taxes payments through fiscal 1999 and added further components to such payments: a parks/related facilities portion, payable through fiscal 2011, of $150,000, to be adjusted annually based upon the percentage increase in the number of annual air passengers at Logan Airport; and a tree planting portion of $12,500, payable through fiscal 1998. In August, 1997, the Authority and Winthrop entered into a further amendment of the Winthrop PILOT Agreement which added another two components to such in lieu of taxes payments: an Ingleside Park/Related Facilities Portion consisting of an annual payment of $383,333, payable each September 1 of fiscal 1998 through fiscal 2000; and an Additional Environmental Portion consisting of an annual payment of $150,000 payable each September 1 of 2001 through fiscal 2005. Neither the Ingleside Park/Related Facilities Portion nor the Additional Environmental Portion are subject to the escalation provisions of the Winthrop PILOT Agreement.

In fiscal 1995, the Authority entered into a comprehensive Amended and Restated Payment-In-Lieu-of-Taxes Agreement with the City of Boston (the "Boston PILOT Agreement"), with a term commencing on March 14, 1995 and ending June 30, 2005. Pursuant to the Boston PILOT Agreement, the Authority will pay to the City the sum of $10 million annually, which payment will be increased by the annual percentage change in the consumer price index, provided that such increase shall be no less than 3%, nor greater than 7%, per year. In August, 1997, the Authority and certain community groups entered into agreements which provide for additional payments under the Boston PILOT Agreement, from a minimum of $4.8 million and up to $9.6 million, with payments to be made as milestones associated with modernization of Logan airport, were reached. These additional payments are not subject to annual adjustments.

The Authority's Enabling Act, the Trust Agreement and the PILOT Agreements provide that annual payments under the PILOT Agreements may not exceed the balance of revenues remaining after deposits to the payment of operating expenses, required deposits to the Interest and Sinking Fund and required deposits to the Maintenance Reserve Fund.

K. Litigation:

In April 1991, the Massachusetts Department of Environmental Protection ("DEP") sent the Authority a Notice of Responsibility ("NOR") under M.G.L. c. 21E, Section 5(a), alleging that there have been releases of oil and hazardous materials at Logan Airport and that, as the owner of Logan Airport, the Authority is a "responsible party" liable for the costs of investigating, assessing and remediating soil and groundwater contamination at the Logan Airport site. Following further assessment activities at Logan Airport, DEP issued another NOR dated March 9, 1994, in which DEP concluded that Logan Airport is not a single contaminated site but rather the location of thirty-one (31) separate and discrete contaminated sites. Assessment and remediation of soil and groundwater contamination at the Logan Airport contamination sites identified by DEP is continuing. While the full nature and extent of the contamination and necessary remedial and cleanup measures have yet to be determined, response costs under c. 21E may be substantial. The Authority, however, has recovered a significant share of its costs of compliance with c. 21E from third parties who are responsible for the contamination and from liability insurance carriers who provided coverage to the Authority. To date, the Authority has recovered $11.1 million dollars from third parties and insurers and has obtained substantial commitments from third parties to conduct further c. 21E compliance measures at a number of the Logan Airport contamination sites identified by DEP. It may be necessary for the Authority to initiate litigation against those few remaining responsible parties that have refused to either agree to perform remedial work or reimburse the Authority. The Authority expects to recover any remaining costs of compliance through rates and charges levied upon users of the Airport.

The Authority is also a defendant in a number of legal proceedings arising in the normal course of business. Management, after reviewing all actions and proceedings pending against or involving the Authority with legal counsel, believes that the aggregate liability of loss, if any, resulting from the final outcome of those proceedings will not materially affect the Authority's financial statements.

L. Leases:

The Authority leases a major portion of its Aviation and Port Properties to various tenants. Most of these operating leases provide for periodic adjustments to rental rates. In addition, certain of the lease agreements contain provisions for contingent payments based on a specified percentage of the tenant's gross revenue. Rental income from contingent payments received under these provisions was approximately $34,864,000 and $29,957,000 for 1998 and 1997, respectively.

Minimum future rental income, excluding contingent rentals, from noncancelable operating leases as of June 30, 1998 are:

Year	Amount (In thousands)
1999	$ 22,766
2000	20,074
2001	19,135
2002	15,696
2003	13,840
Thereafter	338,423
Total	$429,934

The Authority has also entered into operating leases as the lessee. The following is a schedule by years of future minimum rental payments under noncancelable operating leases as of June 30, 1998:

Year	Amount (In thousands)
1999	$ 16,453
2000	15,460
2001	13,172
2002	13,186
2003	13,200
Thereafter	69,414
Total	$140,885

Rent expense was $15,632,203 and $16,732,000 for 1998 and 1997, respectively.

During 1998, the Authority made a payment of approximately $5 million to one of its lessees as an incentive for them to construct a new hotel facility at Logan Airport. The payment is included as part of construction in progress as of June 30, 1998, and is being amortized on a straight line basis over the expected contract period.

M. Subsequent Events:

On August 13, 1998, the Authority issued $67,705,000 in Revenue Bonds, Series 1998-D and $85,285,000 in Revenue Bonds, Series 1998-E to fund the construction of various airport and airfield improvements and to acquire various segments of airport roadways from the Massachusetts Highway Department.

Properties and Performance FY 98

Gross Revenues, Authority-wide	$ 330.6 million
Net Income	$ 49 million
Logan International Airport, East Boston	
Total Passengers	26 million
Domestic	19.8 million
International	3.8 million
Total Pounds of Cargo and Mail	996.3 million
L.G. Hanscom Field, Bedford	
Total Operations	186,441
Tobin Memorial Bridge	
Total Vehicle Crossings	24.9 million
The Waterfront - Port Industry Facilities	
Moran Terminal - Charlestown	
Automobile Processing	72,333
Mystic Pier - Charlestown	
Salt (short tons)	109,138
Conley Terminal - South Boston	
Container Volume	82,296*
Army Base, South Boston	
Cement Handled (short tons)	139,066
Waterfront Properties	
Fish Pier, South Boston	
Fish Processed, pounds	20 million
Fish Landed, pounds	5 million
Black Falcon Cruise Terminal, South Boston	
Total Cruise Passengers (cruise season-1997)	109,708

*includes "Over the Road" volumes.

World Trade Center Boston, South Boston

Exhibition and conference space at Commonwealth Pier leased to private developers.

Constitution Plaza, Charlestown

Multi-purpose office and retail space at Hoosac Pier leased to private developers.

East Boston Shipyard, East Boston

Lease to private entity for ship repair and marine industrial development.

Equal Opportunity For All

In support of the basic principles of the Massachusetts Executive Orders, and in compliance with state and federal laws on affirmative action, Massport is committed to a program of effective affirmative action through institutionalized procedures that ensure equal opportunity in personnel practices, daily operations and business transactions.